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ENERGY FOR DAVID PUMPHREY
STATE FOR EB/ERF

E.O. 12356: N/A
TAGS: ENRG, EPET, EINV, EFIN, EMIN, ECON, CO
SUBJECT: AMBASSADOR'S MEETING WITH MINISTER OF MINES AND
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1. SUMMARY: THE AMBASSADOR'S INTRODUCTORY CALL ON
MINISTER OF MINES AND ENERGY VERGARA FOCUSED ON
FOLLOW-UP ACTIONS TO THE AUGUST 1-2 BILATERAL ENERGY
MEETING IN WASHINGTON. DISCUSSION ALSO TOUCHED ON THE
PROSPECTS FOR DEVELOPMENT OF THE RECENT MASSIVE OIL
DISCOVERY IN THE CASANARE, STATUS OF THE CARBOCOL
EXIMBANK DEBT RESCHEDULING, AND PRIVATIZATION OF THE
FINANCIALLY TROUBLED ELECTRICAL SECTOR. END SUMMARY

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UNITED STATES DEPARTMENT OF STATE
REVIEW AUTHORITY: OSCAR J. OLSON
DATE/CASE ID: 13 NOV 2002 200201334

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2. BILATERAL ENERGY COOPERATION

THE AMBASSADOR AND ECON COUNSELOR MET WITH MINISTER OF MINES AND ENERGY LUIS FERNANDO VERGARA ON OCT 1 TO DISCUSS U.S./COLOMBIA ENERGY COOPERATION ISSUES, AS A FOLLOW-UP TO THE AUG 1-2 BILATERAL MEETING HELD IN WASHINGTON (REFTEL B). VERGARA WAS VERY PLEASED WITH THE RESULTS OF THE MEETING, NOTING THAT SPECIFIC AREAS FOR POTENTIAL COOPERATION WERE IDENTIFIED WITH A NUMBER OF USG AGENCIES (DOE, AID, TDP). HE IS MOST INTERESTED IN OBTAINING TECHNICAL ASSISTANCE ON CLEAN COAL/COAL GASSIFICATION, ENVIRONMENTAL MANAGEMENT AND REGULATION, ENERGY EFFICIENCY, AND PRIVATIZATION. THE NEXT STEP IN THE PROCESS, VERGARA SAID, WOULD BE THE VISIT OF A U.S. TECHNICAL TEAM TO COLOMBIA.

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3. VERGARA NOTED THAT COLOMBIA HAS EXTENSIVE COAL AND PRECIOUS METAL RESERVES, BUT EXPLOITATION OF THESE RESOURCES HAD CAUSED SIGNIFICANT ENVIRONMENTAL DAMAGE. COLOMBIA IS ONE OF LATIN AMERICA'S TOP GOLD PRODUCERS, PRIMARILY THROUGH SMALL DREDGING OPERATIONS WHICH REQUIRED THE USE OF TOXIC AND HEAVY METALS TO RECOVER THE GOLD. ALTHOUGH LARGE-SCALE COAL OPERATIONS SUCH AS CERREJON HAD ENVIRONMENTAL MANAGEMENT PROGRAMS IN PLACE, THE SMALL COAL MINES PRESENTED PROBLEMS.

4. CARBOCOL DEBT RESCHEDULING

VERGARA REVIEWED THE BACKGROUND OF THE CARBOCOL DEBT ISSUE, NOTING THAT THE ECONOMIC FEASIBILITY STUDIES FOR THE CERREJON PROJECT HAD PROJECTED MUCH HIGHER COAL PRICES THAN ACTUALLY RESULTED. BOTH EXXON AND CARBOCOL WERE CONTINUING TO INVEST IN THE PROJECT TO EXPAND PRODUCTION CAPACITY FROM THE CURRENT 15 MMT TO 22 MMT WHICH WOULD SIGNIFICANTLY LOWER UNIT COSTS. THE MINE IS AN EFFICIENT PRODUCER OPERATIONALLY, BUT FINANCIAL COSTS ARE HIGH. VERGARA SAID THAT THE GOC HAS CONTRACTED A U.S. INVESTMENT BANK (MORGAN) TO DRAFT A PRIVATIZATION PLAN FOR CARBOCOL'S HOLDINGS IN THE CERREJON MINE. THE GOC IS COMMITTED TO PRIVATIZATION; BUT VERGARA INSISTED THAT THEY WOULD STUDY CAREFULLY ALL THE OPTIONS PRIOR TO A DECISION. THEY DO NOT WANT TO SELL CARBOCOL'S SHARES IN A DEPRESSED MARKET FOR COAL PROPERTIES.

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5. PETROLEUM DISCOVERY IN THE CASANARE

DISCUSSION THEN TURNED TO THE RECENT ANNOUNCEMENT OF A
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MASSIVE PETROLEUM DISCOVERY IN COLOMBIA'S CASANARE
INTENDENCY. THE FIELD, CUSIANA II, WAS JOINTLY EXPLORED
BY BRITISH PETROLEUM, TRITON ENERGY CORP (U.S.) AND
TOTAL (FRANCE), AND HAS AN ESTIMATED 3 TO 5 BILLION
BARRELS OF RECOVERABLE LIGHT CRUDE (30 TO 37 DEGREES
API) AS RESERVES. HOWEVER, THE OIL-BEARING STRUCTURE IS
DEEP (15,000 FT), MAKING WELLS DIFFICULT AND EXPENSIVE
TO DRILL. THE FIELD CONTAINS SIGNIFICANT AMOUNTS OF
NATURAL GAS, WHICH WILL LIKELY BE PASSED THROUGH A
SEPARATION PLANT AND THEN REINJECTED. VERGARA NOTED
THAT ANOTHER OIL FIELD (RUBIALES) WOULD LIKELY BE
DEVELOPED IN CONJUNCTION WITH CUSIANA. RUBIALES IS
UNDER EXPLORATION BY TUSKAR RESOURCES PLC (IRELAND), AND
CONTAINS ABOUT 350 MILLION BARRELS (RECOVERABLE) OF
HEAVY CRUDES. THE PLAN WOULD BE TO BLEND SOME OF THE

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SUBJECT: AMBASSADOR'S MEETING WITH MINISTER OF MINES AND
LIGHT CRUDES FROM CUSIANA WITH THE PRODUCTION FROM
RUBIALES. ECOPETROL IS STUDYING THE CONSTRUCTION OF A
NEW REFINERY WHICH COULD PROCESS CRUDE PETROLEUM FROM
THESE NEW FIELDS.

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6. PETROLEUM: INVESTMENT CLIMATE

THE AMBASSADOR RAISED THE PROBLEMS OF COLOMBIA'S
INVESTMENT CLIMATE FOR PETROLEUM, NOTING THAT THE
ASSOCIATION CONTRACT AND TAX REGIME WERE ADEQUATE FOR
LARGE SCALE OPERATIONS SUCH AS OCCIDENTAL'S CANO LIMON
AND THE CUSIANA FIELD, BUT NOT FOR SMALL AND
MEDIUM-SIZED DEPOSITS. COLOMBIA IS COMPETING FOR SCARCE
INVESTMENT CAPITAL WITH OTHER COUNTRIES, HE NOTED, AND
SHOULD WORK TO FURTHER IMPROVE ITS INVESTMENT CLIMATE.

7. VERGARA WAS AWARE OF THE ECONOMIC DISINCENTIVES FOR
SMALL AND MEDIUM DEPOSITS BUT INSISTED THAT ONE OF THE
GREAT ADVANTAGES OF COLOMBIA'S ASSOCIATION CONTRACT WAS
ITS TRANSPARENCY. HE SAID THAT WHILE THE CONTRACT WAS
INFLEXIBLE, THE GOC IS WELL-REGARDED BY PETROLEUM
COMPANIES FOR THE SPEED IN WHICH NEW CONTRACTS ARE
NEGOTIATED AND APPROVED. THE DISCOVERY OF OCCIDENTAL'S
CANO LIMON FIELD GENERATED A HEATED POLITICAL DEBATE ON
THE ASSOCIATION CONTRACT FRAMEWORK IN 1984 BECAUSE OF
THE POTENTIAL FOR "HUGE" PROFITS BY THE MULTINATIONAL
OIL COMPANIES. COLOMBIA HAD ALWAYS RESPECTED THE TERMS
OF CONTRACTS ONCE SIGNED, VERGARA SAID. IT WOULD BE
PREFERABLE TO PROVIDE SPECIAL TAX INCENTIVES OR IMPROVE
THE INFRASTRUCTURE THAN TO REVISE THE ASSOCIATION
CONTRACT SCHEME. HE POINTED TO THE RECENT TAX REFORM
WHICH LOWERED REMITTANCE TAXES FROM 20 TO 12 PERCENT AND
THE REDUCTION IN INCOME TAXES AS PROOF THAT THE GOC DID
WANT TO ATTRACT INVESTORS FOR THE SMALLER PETROLEUM
DEPOSITS.

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8. ELECTRICAL SECTOR PROBLEMS

VERGARA REVIEWED BRIEFLY THE FINANCIAL PROBLEMS OF COLOMBIA'S ELECTRICAL SECTOR, NOTING THAT DEMAND GROWTH FORECASTS HAD BEEN OVERESTIMATED AND THAT THE GOC HAD OPTED FOR MASSIVE HYDRO-ELECTRIC COMPLEXES OVER SMALLER, MORE CAPITAL-EFFICIENT THERMO GENERATING PLANTS. THE ELECTRICAL SECTOR ACCOUNTED FOR ABOUT A THIRD OF COLOMBIA'S FOREIGN DEBT, AND WAS LARGELY BANKRUPT. HE SAID THAT POOR ADMINISTRATION, CORRUPTION, AND OTHER PROBLEMS WERE ALSO RESPONSIBLE FOR THE HUGE COST OVERRUNS ON PROJECTS IN EXECUTION, SUCH AS THE GUAVIO HYDRO COMPLEX.

9. VERGARA SAID THE GOC IS PRESENTLY PREPARING A RESTRUCTURING PLAN FOR THE SECTOR, INCLUDING THE SUBMISSION OF LEGISLATION TO THE NEXT CONGRESS WHICH WILL PERMIT THEM TO PRIVATIZE SOME GENERATING PLANTS. THEY WANT TO PERMIT PRIVATE SECTOR PARTICIPATION IN ELECTRICAL GENERATION, INCLUDING CO- AND AUTOGENERATION. DISTRIBUTION OF ELECTRICITY WAS A MORE DIFFICULT PROBLEM TO RESOLVE, VERGARA SAID, SINCE THE GOC HAD TO WORK OUT MORE EFFECTIVE TARIFF RATES AND COLLECTION METHODS.

10. VERGARA SAID THAT SEVERAL CONCRETE PRIVATIZATION ACTIONS WERE ALREADY UNDERWAY. THE GOC HAS REQUESTED BIDS FOR THE TRANSPORT AND INSTALLATION OF SEVERAL GAS-FIRED TURBINES TO BARRANQUILLA, WHERE THEY WOULD BE OPERATED BY A PRIVATE COMPANY. IN ADDITION, THE

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 OIL-FIRED ELECTRICAL GENERATING PLANT FOR THE ISLAND OF SAN ANDRES WAS OPENED FOR PRIVATE INVESTMENT.

11. COMMENT

VERGARA HAS BEEN CRITICIZED BY PRESIDENT GAVIRIA FOR NOT MOVING RAPIDLY AND DECISIVELY ENOUGH ON PRIVATIZING THE ELECTRICAL SECTOR. TO SOME EXTENT, HIS HANDS ARE TIED. COLOMBIAN LAW PRESENTLY DENIES PRIVATE SECTOR THE RIGHT TO SELL ELECTRICAL POWER. THIS WILL BE CHANGED IN THE LEGISLATION BEING PREPARED. HOWEVER, VERGARA WOULD BE WELL ADVISED TO ACT QUICKLY TO AWARD MANAGEMENT

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CONTRACTS TO PRIVATE COMPANIES IN ORDER TO TAKE OVER
SOME OF THE BADLY ADMINISTERED ELECTRICAL COMPANIES AND
SET THEM ON THE ROAD TO SOLVENCY BEFORE ACTUAL TRANSFER

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OF ASSETS TO THE PRIVATE SECTOR TAKES PLACE. END COMMENT
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